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Memorandum

TO: BATA Oversight Committee — DATE: September 1, 2010

FR: Executive Director — W. I. 1252

RE: BATA Bond Financing BATA Resolution No. 95

Resolution No. 95 adds variable rate demand bonds to the mix of taxable and tax-exempt bonds authorized by Resolution No. 92 and approved by the Authority in April, 2010. Resolution No. 95 also authorizes the refinancing of existing BATA bonds if the refinancing meets economic threshold or program purposes.

Build America Bonds (BAB)

Resolution No. 92 authorized the issuance of up to $4.0 billion in fixed rate, subordinate taxable or tax-exempt bonds. In July, 2010, BATA issued the first $1.5 billion in subordinate, taxable toll revenue bonds. The sale was difficult, however, the results were positive. BATA sold the subordinate bonds at an overall taxable rate of 7.02% which, after subsidy, produces a net rate to BATA of 4.54%.

The value of the taxable Build America Bond (BAB) program has been the ability to produce financing costs that were lower than traditional tax-exempt markets. BATA, for example, has a net rate for its “A” rated, 40 year subordinate toll revenue bonds of 4.54%. However, had BATA attempted a 40 year tax-exempt financing with the same terms as the taxable BAB issue, the expected rate would have been much higher, approximately 5.40%. The value of the BAB issuance compared to the same structure in the tax-exempt market was approximately $364 million over the 40 year financing life ($174 million present value).

In addition to the added value, the BAB program has other financing advantages, as well as additional risks. These factors include:

Advantages

- Market Size — The BAB program offers access to thousands of new investors, producing more competition for municipal bonds
- Issue Size — Taxable investors prefer larger size deals for liquidity (trading) purposes.
- Term — Taxable investors like 30 and 40 year bonds, while 25-30 is the norm in the tax-exempt market.

Disadvantages

- Federal Subsidy — Dependence on the federal government to make required payments.
- Federal Intercept — The power of the U.S. Treasury to offset interest payments for other amounts (usually grants or payroll taxes) owed the federal government.
- Legislative Change — Risk the U.S. Congress might change the subsidy or payment rules.
- Program Termination — Risk that the program will sunset in December, 2010 has kept a number of investors away.

Overall, we believe the value of the program has outweighed the risks. BATA has issued a total of $2.8 billion in taxable Build America Bonds at a weighted average interest rate of 4.32%, a present value savings of approximately $450 million over what a comparable issue would have cost in the tax-exempt market.

Resolution No. 95

Resolution No. 95 expands the financing tools to include variable rate bonds and authorizes BATA to evaluate refunding opportunities.

Variable Rate Bonds

Resolution No. 92 authorized the issuance of up to $4.0 billion in fixed rate taxable or tax-exempt bonds. Staff did not originally request variable rate bond authority because of our belief that we had over-utilized that part of the market. However, in meeting with investors this year, we have found that there might be an unexpected market for both taxable and tax-exempt variable rate bonds. Given the low rates of variable rate bonds and the availability of credit support, staff is requesting to add variable rate bonds as a financing option. This request does not increase the $4.0 billion principal value authorized in Resolution No. 92, but simply adds variable rate bonds to the financing mix. In addition, it remains our strong preference to keep BATA's debt portfolio heavily weighted towards fixed-rate bonds.

Refinancing

During the financial and liquidity crisis that began in 2008, BATA issued more than $1.5 billion in fixed rate bonds that were used to refund variable and auction rate bonds. A good portion of these bonds ($1.1 billion) have coupon rates in excess of 5.00%, with some as high as 5.60%, at a weighted average rate of 5.16%.

Interest rates have come down significantly since the hectic days of 2008-2009. The current 25 year revenue bond index is 4.69%. Consider an example of approximately $250 million with an average coupon of 5.50% for 25 years. If refunded at current rates (4.69%), the net result produces a nominal savings of $32 million ($19.5 million present value). While the market will probably not absorb a "mega" refinancing, we may be able to selectively choose maturities for refunding candidates. We believe that the current low rate environment, particularly for highly rated revenue bonds such as those issued by BATA, is an opportunity that should be evaluated for economic, as well as structuring effectiveness, on a maturity by maturity basis.

Staff recommends Resolution No. 95 for approval and submission to the Authority for consideration.

Steve Heminger

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